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RR RUEHLMC  
DE RUEHJA #1949/01 3291008  
ZNR UUUUU ZZH  
R 251008Z NOV 09  
FM AMEMBASSY JAKARTA  
TO RUEHLMC/MILLENNIUM CHALLENGE CORP WASHINGTON DC  
RUEHC/SECSTATE WASHDC 3931  
INFO RUEATRS/DEPT OF TREASURY WASHDC

UNCLAS SECTION 01 OF 03 JAKARTA 001949

STATE FOR EAP/MTS, EAP/EP, EEB/IFD/ODF  
AIDAC FOR ANE, EGAT  
USTR FOR (EBRYAN)  
TREASURY FOR (BPELTON)

SIPDIS

E.O. 12598: N/A

TAGS: [EAID](#) [PREL](#) [PGOV](#) [ETRD](#) [ECON](#) [KMCA](#) [MCC](#) [ID](#)

SUBJECT: MCC VISIT: NOW IS THE TIME FOR INTENSE WORK

¶1. (U) SUMMARY. The MCC visit has successfully refocused Indonesian attention on a MCC Compact. Meetings with key ministers, the local Indonesian technical team, and many experts provided valuable input as well as allowed sharing of the requirements and timeline for a Compact. However, work is just beginning and a tremendous amount needs to be done in the next several months to be on target for a FY 2011 signing. Challenges center on the need to strengthen the Indonesian team and to maintain the focused attention of officials, particularly at the operational level for development of high quality proposals. MCC team appreciated help provided by the Embassy and the Ambassador personally. The achieved involvement of high level GOI officials and the resulting expectations generated make reselection more crucial. See Action Request (Para 13). END SUMMARY

¶2. (U) BACKGROUND ON VISIT. An MCC team visited Indonesia from November 10 Q 22 to review progress to date, meet key new Cabinet members and the local Indonesian technical team, and convey a sense of urgency about the timeline ahead. Team members included MCC Acting Vice President for Compact Development Darius Teter, Acting County Director Magda Ismail, lead economist Peter Rosner, monitoring evaluation expert Jeff Brown, environmental and social assessment expert Sergio Feld, and program analyst Martha Bowen.

¶3. (U) PROGRESS IN COMPACT DEVELOPMENT TO DATE. Since Indonesia's selection in December 2008, the GOI has gotten off to a relatively slow start, partly due to elections and naming a new cabinet. A technical team under the National Development Planning Agency (BAPPENAS) was put in place in October. With assistance from the Asian Development Bank, Islamic Development Bank and the ILO, an analysis of constraints to growth, one of first steps in the development of a compact, was presented November 10th. Funds for compact development have been secured in the 2010 budget, starting in January.

¶4. (U) KEY TASKS NOW. MCC alerted the GOI that in order to sign a compact by FY 2011, the GOI will need to follow an aggressive timeline, including finalizing a list of strategic priority areas, soliciting and screening project concepts, and consulting with stakeholders, thereby developing concepts that address the country's most urgent priorities. It is essential that the GOI hone in on a few specific sectors or themes to focus their public consultations and identify potential investments. The concepts must show a) sufficiently high economic rates of return; b) clear rationale based on constraints to growth and poverty reduction and with clearly identified beneficiaries; and c) capacity of executing agencies or government ministry to implement the project within five years. Given the vast size of the Indonesian economy, a desirable feature would be the ability of the project to

leverage funding from other sources (government, private sector, NGOs or donors). The development of the concept papers must be done in the next several months in order to allow time for substantial feasibility work and environmental and social impact assessments (which MCC is willing to fund.) For more complex and ambitious infrastructure projects, these studies may require a full year.

15. (U) CHALLENGES. The two main issues are: helping the Indonesian team and keeping high level officials involved. The present GOI technical team is enthusiastic, but has limited experience in project identification, conceptualization and design, and lacks full-time high caliber leadership. The GOI has budget for recruiting staff and consultants, but GOI procurement procedures make it likely that creative solutions will be needed in order to be able to hire at market rates top talent to lead the process. The setup structure and reporting arrangements for the team may be overly complicated and stratified. As noted below key GOI officials are ready to help, but keeping them informed and engaged will be a challenge.

16. (U) Positive Engagement. The GOI demonstrated continued interest and intellectual engagement in the opportunities afforded by MCC eligibility. The MCC team met with Minister of Finance Sri Mulyani, Minister of National Development Planning Armida Alisyahbana, Head of the Presidential Delivery Unit Kuntoro Mangkusubroto, Director General for US and Europe at the Ministry of Foreign Affairs Retno Lestari Priansuri, and the Deputy Coordinating Minister for Economic Affairs Erlangga Mantik.

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They also met with donors, leading economists, environmental and women's NGOs, the national bureau of statistics, several other government ministries, and the Indonesian core technical team.

17. (U) Minister Sri Mulyani. Minister Mulyani stated that in the bilateral context, Presidents SBY and Obama want to elevate the relationship between the United States and Indonesia to a higher level, especially on the policy and economic front. In the context of her focus on accountability for results and government effectiveness, Mulyani suggested that rather than simply funding activities already undertaken by Government, they should look for higher-profile and demonstration opportunities.

Mulyani mentioned that MCC funding can be leveraged in a variety of sectors and can be combined with resources from local government and national government. Mulyani offered to be the goal keeper in vetting proposed project concepts for MCC investment to ensure quality.

The MCC team had a two-hour brainstorming session with Mulyani who had a plethora of project ideas, providing in her words a menu from which MCC would select projects such as:

a. Basic Infrastructure (clean water supply): Create incentives for local government, including water pricing policy.

b. Education: combine government resources (20% of GOI budget is supposed to be allocated to education) with donor resources for a World Bank project for school grants that would give the right incentives to local government. Another idea would be to use MCC funding for increasing the number of scholarships for students, particularly for civil servants, to complete graduate studies in the US.

c. Economy: Assist with fiscal policy, social safety nets and fuel subsidy issues, which is consistent with G-20 and US policy.

d. Tax administration: Improve tax collection capacity and transparency, reform the department of taxation, improve tax collection, and reduce tax evasion. The government is currently implementing a second phase of tax reform which involves improving: a) database and IT system for taxes; b) quality of human resources in tax auditing and investigation; and c) credibility of the relationship of the tax authority with the tax payer.

e. Investment Climate: Improve the investment climate. At APEC, President Obama mentioned his interest in improving the investment climate through the free flow of goods for trade and creating an ASEAN single window for imports and exports. Domestically Minister Mulyani stated that the quality of the national single window should continue to be improved.

f. Performance Based Budgeting: Increase the implementation of performance based budgeting and improve the expenditure policy in Kabupatens (districts). Starting from January 2010, Minister Mulyani will create an incentive reward system where Kabupatens are rewarded with the equivalent of \$1.8 million USD when they demonstrate improved performance; there are over 550 Kabupatens in Indonesia. Indicators that are used for improved performance could be possibly topped-up with MCC indicators.

g. Climate Change: Mulyani mentioned that Indonesia has an Open menu on Climate Change. MCC's environment expert held many meetings with various stakeholders during this visit to better understand climate change issues in the context of Indonesia.

18. (U) Minister Armida Alisyahbana. Minister Armida is new but is quickly familiarizing herself with the MCC program. She is concerned about continued eligibility and scorecard data accuracy. Minister Armida mentioned that sustainability, the role of private sector (through public private partnerships), and the role of the regions are all factors which should be taken in consideration when selecting a project.

19. (U) Kuntoro Mangkusubroto. Kuntoro has overall responsibility for encouraging the effectiveness,

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coordination, and collaboration of government ministries and has hands-on experience in donor relations, coordination and project execution through his previous role as head of the Aceh Recovery program. Kuntoro immediately recognized the importance of a champion to see the compact through to completion. However, he believed the Compact was not big enough or driven by an urgent enough rationale to merit an arrangement such as the reconstruction agency which he successfully headed in Aceh. He did assign his senior deputy Heru Prasetyo to follow up on the MCC Compact development.

10. (U) Indonesia Selection. The MCC team explained that Indonesia will need to be reselected by the MCC Board at its upcoming board meeting on December 9 in order to continue its engagement with MCC. In making its eligibility decisions, the Board may take into consideration both Indonesia's current scorecard performance as a Lower Middle Income Country (LMIC), as well as the fact that Indonesia would have met the criteria as a Low Income Country (LIC), including the Control of Corruption indicator. The MCC team expressed confidence that Indonesia will be reselected based on its performance as an LIC; however it cannot presume the board's decision.

11. (U) Scorecard and Legislative Fix. Several questions from the GOI centered on Indonesia's scorecard, the accuracy of the indicators, and the potential amount of the Compact. MCC team urged the GOI to be in touch with the

organizations that collect the indicator data to ensure the accuracy and timeliness of reporting. Under MCCQs statute, LMICs have access to a maximum of 25 percent of funds appropriate in any fiscal year Q a trivial amount for Indonesia even under an optimistic FY2011 budget scenario. MCC has been working with on legislative language that would essentially grandfather IndonesiaQs status as an LIC for funding. A version of the language may be in the final FY2010 appropriations bill.

¶12. (U) Gratitude. The MCC team expressed gratitude to Ambassador Hume for his personal interest and support of MCC and for convening meetings with key ministers and government officials, including hosting a breakfast, and to Walter North and his team at USAID for their continued support, including helping to organize the MCC visit and providing bridge funding for the Indonesian technical core team.

¶13. (U) Action Request. The enthusiasm generated by the MCC visit among high level GOI officials makes it all the more critical that Indonesia be reselected. The Post appreciates everyoneQs continued efforts to ensure this. Thanks.

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